

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-596

September 8, 1999

PUBLIC UTILITIES COMMISSION
Investigation of Stranded Cost Recovery,
Transmission and Distribution Utility
Revenue Requirements, and Rate Design of
Bangor Hydro-Electric Company

ACCOUNTING ORDER

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

In this Order, we approve in part and deny in part Bangor Hydro-Electric Company's Request for an Accounting Order Regarding Electric Industry Restructuring Costs (Request). Specifically, we find that electric restructuring is the type of extraordinary event which warrants the deferral of prudently incurred incremental costs. We therefore allow Bangor Hydro-Electric Company (BHE or Company) to defer such prudently incurred incremental costs caused by electric restructuring for future recovery in rates. However, not all costs requested by BHE for deferral are caused by restructuring. In addition, certain costs related to restructuring cannot be viewed as incremental. In those instances, we deny BHE's request. In particular, where BHE will rely on existing employees to perform tasks specifically related to electric restructuring, we find that such costs are partly incremental and will allow the Company to defer 50% of the direct costs resulting from those tasks, as well as a portion of the Administrative and General (A&G) and other overheads attributable to such costs.

II. PROCEDURAL HISTORY

See Appendix A.

III. POSITIONS BEFORE THE COMMISSION

A. BHE's Initial Request

The Company seeks the deferral of certain one-time costs associated with electric restructuring related projects. The specific costs requested for recovery and the estimate of these costs are set forth in the table below:

Budget No.	Project	1999	2000
1335	DSM-Docket 97-371	\$ 7,000	
1371	Advertising-Restructuring Consumer Ed	\$ 317,000	\$168,000
1415	Web page	\$ 59,000	\$ 40,000
1752	CIS	\$ 0	\$125,000
1795	Advertising-Customer Service/Restructuring	\$ 15,000	\$ 58,000
1796	Educational Services/Restructuring	\$ 7,000	
1797	Marketing-C/I Customer Assist./Restructuring	\$ 9,000	
1798	Marketing-Corporate Research/Restructuring	\$ 8,000	
1799	Marketing-General Admin./Restructuring	\$ 19,000	
1801	Marketing-Key Accounts/Restructuring	\$ 15,000	\$ 0
1802	Load Profiling	\$ 27,000	
1804	CSC Ops/Restructuring	\$ 255,000	
1806	Meter Ops/Restructuring	\$ 53,000	
1807	CS Support Ops/Restructuring	\$ 175,000	
1803	Support Business Unit/Restructuring	\$ 482,000	\$237,500
	Indirect Expense	\$ 447,000	\$303,000
	Total	\$1,895,000	\$931,500

Carroll Lee testified on behalf of BHE that the costs in question are properly the subject of an accounting order primarily because of the implementation of the alternative rate plan ("ARP") for the Company. Under the ARP, the Company is allowed a pre-determined rate change (inflation minus productivity offset), but is not allowed to seek a general rate increase through February 29, 2000. Mr. Lee stated that:

[T]he implementation of electric industry restructuring in Maine has imposed new operational requirements on the Company in order to facilitate the transition to restructuring. Thus, the Company's opportunities to reduce staffing levels through attrition, or otherwise, and to reduce other operational costs, such as training and advertising expenses, have been compromised by actions of the Legislature and the Commission with respect to industry restructuring.

Mr. Lee noted that in the Black/Dawes Rebuttal Testimony filed in Docket No. 97-596 the Company requested to defer \$822,600 in "incremental" non-capital restructuring costs for the 1999 and 2000 time period. This estimate was based on increased costs over test year levels to implement restructuring. As part of its Request for an Accounting Order, the Company had modified its definition of "incremental" to include all non-capital restructuring-related costs. Mr. Lee stated, however, that the Company was not, as part of its request, seeking to recover incremental restructuring-related capital costs incurred in 1999 or 2000 and ongoing restructuring-related O&M costs. The Company would seek recovery of these costs as part of its general rate request later in this proceeding.

B. The OPA

Through its expert witness, Lane Kollen, the OPA recommends the following four adjustments to the Company's request.

First, Mr. Kollen recommends the removal of internal labor and indirect costs that are not incremental (\$712,000 in labor and \$447,000 in indirects in 1999 and \$395,000 in labor and \$303,000 in indirects in 2000). Mr. Kollen argues that these costs are not incremental because they are not "in addition" to costs that otherwise would have been incurred. The requested costs are merely a reallocation of existing resources and costs. While the Company has added some positions to its payroll, the Company's overall employee headcount is expected to go down during 1999, even after accounting for the divestiture of the generation function.

Because "indirect costs" (benefits and overheads) are a function of labor costs, logical consistency dictates that these costs should also be denied as being non-incremental. Mr. Kollen notes that in calculating the interim revenue requirement savings in its rate case, the Company did not include overhead savings associated with the decreased generation labor costs and only accounted for a portion of such costs for the rate year starting on March 1, 2000. According to Mr. Kollen, the Company's position in the Accounting Order Request and in the rate case are inherently inconsistent and cannot both be correct.

Second, Mr. Kollen recommends that the DSM costs (\$7,000) and web page costs be removed, as they are unrelated to restructuring. At a minimum, the Company's web page request should be reduced by \$25,000, the amount budgeted for the web page in 1998.

Third, Mr. Kollen argues that advertising expenses be removed since the Company has not demonstrated that the Company's restructuring advertising meets the requirements of Chapter 302, § 6A of the Commission's Rules, which requires it to demonstrate that its restructuring advertising is "reasonably effective, necessary and in the public interest" before such amounts are included in rates. In addition, Mr. Kollen argues that the advertising costs requested are included in the overall 1999 advertising budget of \$349,000, which is less than 1996 (\$660,470), 1997 (\$576,021) and 1998 (\$455,643) levels. Thus, the restructuring related advertising expenses cannot be seen as incremental.

Fourth, Mr. Kollen recommends that any costs that will ultimately be recovered from suppliers be removed from the Company's request.

In addition to the adjustments to the Company's Request for an Accounting Order, Mr. Kollen recommends that any restructuring costs deferred should

be netted against the interim revenue requirement savings.¹ Mr. Kollen also recommends that the amortization period for the deferred expenses be set in the main part of the rate case proceeding and be tied to the stranded cost review period.

C. The Bench Analysis

On June 1, 1999, the Commission's Advisory Staff submitted its Bench Analysis in this matter. The Staff set forth the following four-factor test to be used in analyzing the Company's request:

1. The costs in question must clearly be the result of electric industry restructuring. To merit special treatment, costs must be the direct result of the policy decision to restructure.
2. The costs must be incremental, in the sense that they must be additional costs which BHE would not incur but for the fact of restructuring.
3. The overall costs associated with restructuring must be large enough to justify special treatment. This criterion applies to total costs, not individual budget items.
4. The costs must be relatively easy to quantify.

Applying the four-factor test, the Bench Analysis went through each cost item requested for recovery by the Company. Based on this analysis, the Advisory Staff recommended that the Company be allowed to defer \$120,000 for restructuring-related regulatory assessments and possibly an additional \$134,000 for miscellaneous advertising, load profiling and customer service.

D. The Company's Response

In response to the Bench and OPA analyses, the Company stated that it was inappropriate to focus on budgeted amounts provided in the Company's case because the Company was not seeking to recover the amounts that are budgeted. The purpose of the budgets was to provide an order of magnitude of the expected expenditure. Thus, the Company argues that the Commission should determine that restructuring costs are an appropriate candidate for an accounting order. The Company would then defer the actual costs incurred to implement restructuring and request recovery of those costs subject to Commission approval of specific amounts.

¹In our decision in *Bangor Hydro-Electric Company, 1999 Rate Plan Annual Review*, Order at 5 (May 28, 1999) we ordered BHE to defer the interim revenue requirement savings associated with its generation asset sale. The exact level of the savings will be decided in the general rate case. We therefore need not address this issue as part of this Accounting Order.

In response to the criticisms of the OPA and the Bench, the Company also modified its position regarding the recovery of A&G expenses. The Company now proposes, consistent with its approach in the rate case and its contention that such costs are relatively “inelastic” in the short term, that it be allowed to recover 50% of A&G overheads which would otherwise be loaded on the directly incurred restructuring related costs.

IV. DECISION AND ANALYSIS

A. General Standards for Review

As a general matter, allowing dollar for dollar retroactive recovery generally blunts the incentives for efficiency we have attempted to build into our ratemaking. See *Central Maine Power Company, Proposed Increase in Rates*, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings at 2 (Jan. 10, 1994). Thus, an Accounting Order allowing a utility to defer certain costs should be seen as an exception to the rule that ratemaking is usually done on a prospective-cost basis. Nonetheless, in the past we have concluded that deferrals are warranted in certain instances where the costs are truly extraordinary, i.e., unusual and sufficiently large that the utility cannot be expected to absorb them without an undue impact on earnings. *Central Maine Power Company, Proposal for Accounting Order on Hurricane Bob Service Restoration Costs*, Docket No. 92-019, Order at 2 (Nov. 10, 1992).

There does not seem to be any disagreement between the Company, the OPA and the Bench Analysis that the costs associated with electric restructuring meet the “extraordinary” standard set forth above. The first factor in the Bench’s four-factor test requires that the costs in question clearly be the result of electric utility industry restructuring. This criterion implicitly recognizes that electric utility restructuring is the type of extraordinary event that would cause us to deviate from our normal practice of not allowing for dollar for dollar recovery of past expenses. We agree with this conclusion.

Both the Bench Analysis and the OPA’s witness suggest that an additional factor, whether the costs incurred are truly incremental, must be considered by the Commission in deciding on a request for an accounting. We agree. The difficult question here is what restructuring-related costs are actually incremental.

B. Defining Incremental Costs

Under the Company’s approach, anything related to electric restructuring would be considered incremental. The Company argues that if it were not for restructuring the Company would be able to achieve benefits for its shareholders, either through the reduction of costs or through increased revenue production. The Company’s position assumes that there is a 100% correlation between an employee’s time and the benefits provided to shareholders. We do not find this premise to be

credible; as a practical matter, not every moment on the job spent by every employee is fully productive. The Company's position also ignores the fact that ratepayers are already paying for some of the costs, at least in a generic sense, in existing rates. An accounting order should not be a vehicle for collecting twice from ratepayers for the same expenses.

We reject, however, the argument advanced by the OPA and the Bench Analysis that incremental costs should be limited to new employees specifically hired to work on electric restructuring issues. It is evident that electric restructuring has placed a significant additional burden on the Company and its existing resources. While limiting costs to new employees has some appeal from an administrative and evidentiary viewpoint, such a requirement would give the Company the perverse incentives either to outsource work which could more efficiently be done in-house, or to fire and rehire existing employees for no substantive reason. Both actions would result in higher costs to the Company's ratepayers.

Our decision as to what constitutes incremental costs in this context thus cannot be made on a broad definitional basis. Instead, we will review each cost category requested by the Company, relying on the following guidelines to decide whether the cost category qualifies for recovery.

We will start with the proposition that to qualify for recovery, the tasks must be a result of restructuring. We will then eliminate costs associated with traditional tasks for which restructuring may create a new context but does not, overall, really increase the magnitude of the task. We will accept, however, those items that have been mandated and those costs that are clearly additional. Where the Company brings on new employees (on a net basis) or uses consultants to perform these tasks, such costs will be viewed as wholly incremental and the Company will be allowed full recovery. What remains, then, are tasks that the Company traditionally performs but that the Company believes will be materially greater because of restructuring and may also require extra staff training or supervision to perform.

As noted above, we do not believe that 100% of an employee's time spent on a new task, such as restructuring, can be saved or used to perform other tasks of equivalent value. In many cases, the Company will be squeezing out additional work from its existing employees that it could not readily capture either in savings, since it is difficult to terminate 10% of a person, or in additional revenues. Nonetheless, the Company is entitled to some compensation for performing restructuring-related tasks with existing resources.

While we do not accept the premise put forth by the Company that all work performed by or associated with restructuring constitutes lost opportunity costs to the Company, we believe that at least some portion of such time likely would have resulted in shareholder gains. By using current staff, the Company is avoiding the costs of hiring new employees or consultants, thereby achieving savings for ratepayers. We think it is reasonable that the Company share in these savings, as an incentive to minimize its

restructuring-related costs. We will, therefore, allow the Company to recover 50% of the directly assignable costs resulting from the use of existing employees to perform electric utility restructuring tasks.

We believe that the sharing mechanism which we adopt will provide the Company with the proper incentives. While the Company will receive from ratepayers 100 cents on the dollar for amounts spent on new hires or consultants retained to perform restructuring work, it will also pay out an additional 100 cents on the dollar. By using an existing employee whose salary is arguably already in rates, the Company will receive 50 cents on the dollar for costs associated with that part of the employees' time devoted to restructuring. That 50 cents, however, is in addition to the dollar of salary which is already embedded in the Company's rates. Thus, every dollar in avoided new employee costs will result in a 50-cent benefit for the Company and a 50-cent savings for its ratepayers.

We will use the Company's request as the starting point of our analysis and then make adjustments based on the above guidelines.

C. Application of Standards to the Cost Categories Requested

1. DSM

Demand Side Management is a task long performed by utilities in Maine. We do not believe costs associated with this task are restructuring related and therefore deny the Company's Request regarding this cost category.

2. Advertising

The Company's current rates are based on a 1996 test year which includes \$403,783 of advertising expense, adjusted for space heating advertising expense. The Company's current rate case is based on a 1997 test year which includes \$399,036. In 1999, the Company has budgeted \$349,000 for advertising, of which it considers \$317,000 to be related to restructuring. We find that the restructuring related advertising budgeted for 1999 by the Company merely replaces the amounts spent for other advertising which are currently included in the Company's rates. Therefore, we conclude that these costs are not incremental and deny the Company's request to defer these costs.

3. Web Page

While some question has been raised by the OPA and the Bench Analysis to whether these cost are restructuring-related, we believe that the Company has carried its burden that the modifications to the Company's Web Page were the result of restructuring. Because all the Web Page costs are for outside services, all such costs will be eligible for deferral.

4. Miscellaneous Advertising and Education Expenses

Pursuant to the provisions of Chapter 302 of our Rules, the costs of utility-sponsored restructuring education are not to be included in a utility's rates unless the utility demonstrates that the utility-sponsored educational activities are reasonable in amount, reasonably effective, necessary and in the public interest. The tasks in this cost category appear to be restructuring-related and to be in addition to the current tasks performed by the Company. Therefore, we will allow the Company to defer these costs. However, at the time the Company requests recovery of the amounts deferred, the Company must demonstrate that the requirements of Chapter 302 have been met. To the extent that these costs are allowable under Chapter 302 of our Rules, where the Company relies on existing employees to perform the restructuring related tasks, 50% of costs will be considered incremental.

5. Load Profiling

These costs are electric restructuring-related and the Company will be allowed to recover such costs subject to the incremental cost sharing provisions discussed above.

6. Customer Service-Related Costs

These cost categories all concern interactions by the Company with its customers. There was a great deal of discussion during the case whether these tasks will be performed with new or existing employees. We believe this issue has been adequately addressed by our incremental cost sharing provision. The Company will be allowed to defer costs in this category which are caused by restructuring subject to the sharing provision.

7. Support Business Unit

This category is actually composed of three subcategories: rate case work, regulatory assessments and load profiling implementation. All costs are restructuring related. The special regulatory assessment for restructuring education is a mandated type cost and the Company should be allowed full recovery for this category. Load profiling and rate case expenses are caused by restructuring, and recovery will be allowed under the incremental cost sharing provisions.

We should note that, in the revenue requirement portion of the rate case, the Company has also requested recovery for legal expenses based on 1997 test year expenditures. As discussed previously, an accounting order should not provide the Company with the means of recovering for the same expenses twice. We will thus assess the Company's request to recover regulatory-related legal expenses in light of our decision to allow the Company to recover rate case legal expenses as part of its Accounting Order Request.

8. Overheads

This category is also composed of subcategories: fringe benefits and A&G allocations. We agree with OPA witness Kollen's assessment that these cost categories should be treated consistently with direct wage costs. Thus to the extent that we have allowed direct wage costs to be deferred either in whole or in part we allow an adder for fringe benefits and overheads based on this base allowance.

The Company, as part of its rebuttal case, recommended that it be allowed to defer 50% of the A&G overhead costs allocated to restructuring expenses utilizing a 17.76% allocation factor. The Company asserts this proposal is consistent with its position in the revenue requirement portion of the rate case.

We find the Company's proposal to include 50% of the A&G overhead otherwise allocated to restructuring expenses based on a 17.76% allocation factor to be reasonable.

9. Costs for the Year 2000

We would allow deferral of the costs for January and February, 2000 consistent with our holdings above.

D. Quantification of Costs

During the course of this proceeding the Company provided budgeted estimates for the cost categories for which it was requesting deferral. Given the novelty of the restructuring tasks to be performed and the seemingly very high level of expenses for January and February of 2000, we do not believe that it is appropriate to decide on the specific amounts to be deferred based on the budgets submitted.

The Bench Analysis recommended that the Commission consider the ease of quantification of costs as a factor in deciding whether to grant a request for deferral. We do not believe that we should disqualify a cost item for deferral at this stage of the accounting order process based on ease of cost identification. Rather, we will require BHE to provide sufficient justification for the costs we allow to be deferred at the time the Company returns to the Commission with its request to allow such costs into rates.

We will, therefore, require the Company to document and submit to the Commission for review its actual deferred restructuring costs. The Company should at that time be prepared to fully support all time and cost allocations made in calculating the costs sought for recovery. Any expended amounts that significantly exceed the estimates provided by the Company in support of its request must be fully explained and supported. To the extent that costs requested for recovery are not adequately supported, the Company runs the risk of disallowance.

At this time, we will not establish the amortization period for recovery of the costs which we will allow to be deferred. The amortization period will be established after we have reviewed the Company's costs filing and, thereby, know the magnitude of the costs to be recovered and the impact of such costs on existing rates.

E. Implications of our Decision

As a general matter, regulatory treatment of similar events, and the costs associated with such events, should be treated in a consistent manner. Thus, parties should expect that our decision in the rate case will be guided by that principle and the decisions reached here. For example, to the extent we have found overhead costs to be incremental, and therefore an allowable restructuring cost, we are likely to treat these costs as avoidable when calculating savings.

Finally, while we believe our decisions here are consistent with our past holdings on cost deferrals and accounting orders, the resolution of the issues presented by the Company's Request should be seen as particularly related to the extraordinary and unusual circumstances presented by electric restructuring. Parties should, therefore, not assume that the resolutions reached here are predictive of the likely outcomes in other cases in which a utility asserts that it is faced with new tasks.

Dated at Augusta, Maine, this 8th day of September, 1999.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

This Document has been designated for publication

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5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

3. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
3. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

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APPENDIX A

On March 30, 1999, BHE filed a Request for an Accounting Order Regarding Electric Restructuring Costs. Along with its Request, the Company submitted the pre-filed testimony of Carrol Lee. The Company's request was originally assigned Docket No. 99-209. After reviewing the Company's request, the Examiner found that since there were common questions of law and fact raised by the Company's Request for an Accounting Order and the Commission's pending Investigation of Stranded Costs, Transmission and Distribution Utility Revenue Requirements and Rate Design for Bangor Hydro-Electric Company (also known as the "mega case"), Docket No. 97-596, the convenience of the parties and witnesses and the interests of justice would be served by consolidating Docket No. 99-209 with Docket No. 97-596 on April 8, 1999.

On June 1, 1999, the Office of the Public Advocate filed the Direct Testimony of Lane Kollen. On that same date, the Commission's Advisory Staff filed a Bench Analysis on the Company's request. The Company filed the rebuttal testimony of Carrol Lee on June 18, 1999.

A hearing on this matter was held on July 14, 1999. At the hearing, Mr. Lee was subject to cross-examination. In addition, Dr. Thomas Austin, the primary author of the Staff's Bench Analysis, was questioned both by counsel for the Company and by the Commissioners. The parties were provided with an opportunity to present oral argument to the Commission. Due to a scheduling conflict, the OPA's witness, Mr. Kollen, was unable to appear at the hearing. Mr. Kollen's deposition was taken in lieu of his appearance and was submitted at the hearing.